Governor Fletcher signs into Law Income Tax Relief for Small Businesses

On June 28, 2006, the Kentucky General Assembly enacted House Bill 1 during an unprecedented five day Special Session. The bill was signed into law by Governor Fletcher the same day. The following is a summary of the main provisions of House Bill 1:

Small Business Alternative Minimum Calculation (AMC) Relief - Effective for Taxable Years Beginning on or After 1/1/06, and Before 1/1/07

Effective for taxable years beginning on or after 1/1/06, and before 1/1/07, the AMC is not due from a corporation if the corporation's gross receipts or gross profits from all sources are $3 million or less. This relief applies to limited liability companies, S-corporations, limited liability partnerships, limited partnerships and C corporations.

Effective for taxable years beginning on or after 1/1/06, and before 1/1/07, the AMC is partially reduced for taxpayers with gross receipts or gross profits from all sources in excess of $3 million but less than $6 million. The reduction in the AMC due is based on one of two formulas, depending on whether the AMC is calculated on gross receipts or gross profits.

1. Ky. Gross Receipts X .00095

   $$\text{Minus } \$2{,}850 \text{ X } \left(\frac{\$6{,}000{,}000 - \text{Ky. Gross Receipts}}{\$3{,}000{,}000} \right)$$

2. Ky. Gross Profits X .0075

   $$\text{Minus } \$22{,}500 \text{ X } \left(\frac{\$6{,}000{,}000 - \text{Ky. Gross Profits}}{\$3{,}000{,}000} \right)$$

Taxpayers that receive the threshold AMC relief still will owe the $175 minimum tax due for tax years beginning on or after 1/1/06, and before 1/1/07 provided that the $175 minimum is greater than the regular income tax or AMC amount.

Restoration of Federal Pass-through Entity Treatment for Taxable Years Beginning on or After January 1, 2007

For taxable years beginning on or after January 1, 2007, all pass-through entities will be treated the same for Kentucky income tax purposes as they are treated for federal income tax purposes except for differences between Kentucky law and federal law. This treatment is sometimes referred to as federal conformity. Limited liability companies, S corporations, limited liability partnerships and limited partnerships will no longer be taxed at the entity level under the corporation income tax. The income will be passed-through and taxed at the ownership level.

For taxable years beginning on or after January 1, 2005 and before January 1, 2007, pass-through entities remain subject to the corporation income tax imposed by KRS 141.040 unless the entity is specifically exempted under KRS 141.040(1).

The bill requires withholding of the income tax due from non-resident individual owners of pass-through entities and from corporate owners of pass-through entities if the corporate owner's only business connection to Kentucky is the ownership interest in a pass-through entity doing business here. This change applies to taxable years beginning on or after January 1, 2007.

Top Corporation Income Tax Rate Reduction - Effective for Taxable Years Beginning on or After January 1, 2007

The current law which reduces the top corporation income tax rate to 6% remained unchanged. This rate drop from 7% remains effective for taxable years beginning on or after January 1, 2007.

New Limited Liability Entity Tax Replaces AMC - Effective for taxable years beginning on or After January 1, 2007

Effective for tax years beginning on or after 1/1/07, a limited liability entity (LLE) tax is imposed on corporations and limited liability pass-through entities except those entities that are exempted by subsection (6) of Section 4 of House Bill 1. The entities exempt from the LLE tax are listed at the end of this section. A minimum of $175 will be due from those entities subject to this new tax.

Except for the $175 minimum, the LLE tax will not apply if the entities' gross receipts or gross profits from all sources are $3 million or less.

Except for the $175 minimum, the LLE tax will be partially reduced for taxpayers with gross receipts or gross profits from all sources in excess of $3 million but less than $6 million. The reduction in the LLE tax due is based on one of two formulas, depending on whether the LLE tax is calculated on gross receipts or gross profits.

1. Ky. Gross Receipts X .00095

   $$\text{Minus \$2,850 X} \left(\frac{\text{\$6,000,000 – Ky. Gross Receipts}}{\text{\$3,000,000}} \right)$$

2. Ky. Gross Profits X .0075

   $$\text{Minus \$22,500 X} \left(\underline{\text{\$6,000,000 – Ky. Gross Profits}} \right)$$

$3,000,000

Entities that are exempted from the LLE tax are:

1. Financial institutions, as defined in KRS 136.500, except banker's banks organized under KRS 287.135 or 286.3-135;
2. Savings and loan associations organized under the laws of this state and under the laws of the United States and making loans to members only;
3. Banks for cooperatives;
4. Production credit associations;
5. Insurance companies, including farmers' or other mutual hail, cyclone, windstorm, or fire insurance companies, insurers, and reciprocal underwriters;
6. Corporations or other entities exempt under Section 501 of the Internal Revenue Code;
7. Religious, educational, charitable, or like corporations not organized or conducted for pecuniary profit;
8. Corporations whose only owned or leased property located in this state is located at the premises of a printer with which it has contracted for printing, provided that:
    a. The property consists of the final printed product, or copy from which the printed product is produced; and
    b. The corporation has no individuals receiving compensation in this state as provided in KRS 141.120(8)(b);
9. Public service corporations subject to tax under KRS 136.120;
10. Open-end registered investment companies organized under the laws of this state and registered under the Investment Company Act of 1940;
11. Any property or facility which has been certified as a fluidized bed energy production facility as defined in KRS 211.390;
12. An alcohol production facility as defined in KRS 247.910;
13. Real estate investment trusts as defined in Section 856 of the Internal Revenue Code;
14. Regulated investment companies as defined in Section 851 of the Internal Revenue Code;
15. Real estate mortgage investment conduits as defined in Section 860D of the Internal Revenue Code;
16. Personal service corporations as defined in Section 269A(b)(1) of the Internal Revenue Code;
17. Cooperatives described in Sections 521 and 1381 of the Internal Revenue Code, including farmers' agricultural and other cooperatives organized or recognized under KRS Chapter 272, advertising cooperatives, purchasing cooperatives, homeowners associations including those described in Section 528 of the Internal Revenue

Code, political organizations as defined in Section 527 of the Internal Revenue Code, and rural electric and rural telephone cooperatives; or

18. Publicly traded partnerships as defined by Section 7704(b) of the Internal Revenue Code that are treated as partnerships for federal tax purposes under Section 7704(c) of the Internal Revenue Code, or their publicly traded partnership affiliates. "Publicly traded partnership affiliates" shall include any limited liability company or limited partnership for which at least eighty percent (80%) of the limited liability company member interests or limited partner interests are owned directly or indirectly by the publicly traded partnership.

New Limited Liability Entity Tax is a Credit Against Income Tax – Effective for Taxable Years Beginning on or After January 1, 2007

Any corporation that is subject to the corporation income tax and LLE tax may use the LLE tax due as a credit against the corporation income tax. This credit is reduced by the $175 minimum tax due and is nonrefundable. The credit shall not be carried forward to future periods.

An individual, limited liability pass-through entity, or corporation that owns a percentage of a limited liability pass-through entity will receive as a nonrefundable credit, a proportionate share of the LLE tax paid by the limited liability pass-through entity. This pass-through credit may be used against individual income tax, corporation income tax or LLE tax depending on the type of ownership. The amount of credit passed through will be reduced by the $175 minimum tax due. The credit allowed members, shareholders, or partners of a limited liability pass-through entity shall be applied to income tax due on income from the limited liability pass-through entity.

Other Credits against the LLE Tax - Effective for Taxable Years Beginning on or After January 1, 2007

As with the AMC, the economic development tax credits, e. g. KREDA, KIRA, etc., can be used against the LLE tax liability. Also, other income tax credits, e.g. recycling and biodiesel credits can be used against the LLE tax liability.

Apportionment

A multi-state pass-through entity that is doing business within and without Kentucky will pass-through its apportionment factor to its corporation ownership to be included in the corporation’s apportionment factor.

Homeowner's Associations

Any homeowner's association that is required to file a federal income tax return on form 1120 H is required to file a Kentucky corporation income tax return on form 720. That statement does not reflect a law change but rather a continuation of our long-standing interpretation of Kentucky's corporation income tax law. KRS 141.010(14)(c) defines "taxable net income" in the case of a homeowner's association. If no income is taxable on the federal form 1120H, no income is taxable on the Kentucky return.

For taxable years beginning on or after 1/1/05 and before 1/1/07, a homeowner's association that meets the definition of corporation in KRS 141.010(24) will be subject to the $175 minimum tax due if the greater of its income or AMC calculations results in a tax due of less than $175.

Homeowner's associations will be exempt from the LLE tax, including the $175 minimum tax for taxable years beginning on or after January 1, 2007.

FutureGen Project

House Bill 1 also provides a sales tax incentive package to lure the FutureGen project to Kentucky. The total incentive package is valued between $60 - $90 million. FutureGen is a $1 billion pilot project exploring the feasibility of using cutting edge technology to create the world's first zero emissions power plant. Seven states, including Kentucky, are proposing 12 different sites.